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Richards, George

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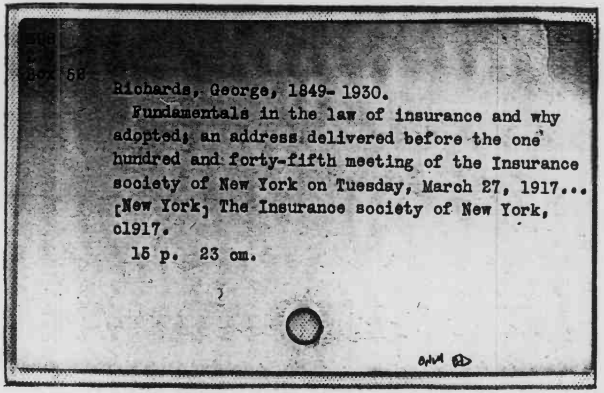
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# Fundamentals in the Law of Insurance and Why Adopted

## *AN ADDRESS*

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DELIVERED BEFORE THE ONE HUNDRED AND FORTY-FIFTH MEETING OF

## The Insurance Society of New York

ON

Tuesday, March 27, 1917

BY

Mr. GEORGE RICHARDS

Richards & Affeld

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# Fundamentals in the Law of Insurance and Why Adopted.

With a mere sprinkling of lawyers, our society is composed of business men, all of whom are engaged in the conduct of some branch of insurance.

It is therefore most fitting to observe that the law of insurance owes its origin and early development to the skill and intelligence of business men. The leading doctrines of insurance law are founded upon trade usage, and trade usage is the result of the experience, not of lawyers, but of the mercantile community —underwriters, brokers—lay experts like yourselves.

John Duer, one of our most learned judges, writing of insurance in his lectures, says: "Merchants were its sole inventors; the custom of merchants supplied the rules by which it was governed, and, for a long period, all its controversies were exclusively decided either by the arbitration of merchants, or by tribunals especially established for their use. It was not a subject of positive law, nor within the jurisdiction of the ordinary courts of justice." And to similar effect, the United States Supreme Court declares "the contract of insurance is an exotic in the common law."

While proud of some of our American institutions, we must frankly admit that the fundamentals of our insurance law, like our common law generally, came to us as an inheritance from England, and the amazing fact is that until the beginning of the seventeenth century, although marine insurance had been practiced to a considerable extent in that and other countries of Europe for hundreds of years, we find no English statute relating to the subject, and no case in the common law reports shedding light on the meaning of the insurance contract.

In the earliest act of Parliament relating to insurance, adopted in 1601, occur the following recitals:

> "Whereas, it hath been time out of mind an usage amongst merchants * * when they make any great adventure * * to give some consideration of money to other persons, * * to have from them assurance made of their goods * ships and things adventured * * which course of dealing is commonly termed a policie of assurance, * * and, whereas, heretofore, such assurers have used to stand so justly and precisely upon their credits as few or no controversies have arisen thereupon, and if they have grown, the same have from time to time been ended and ordered by certain grave and discreet merchants appointed by the Lord Mayor of the City of London," etc.

These instructive statements sanctioned by Parliamentary authority are sufficient guaranty to us that the principles of insurance law, prevailing in England prior to the year 1601, must have been formulated without substantial aid from the common law courts of that country.

To investigate, then, the origin of insurance law as based upon trade custom, I shall ask you to take a brief glance at the maritime situation as it existed in England prior to the date of that statute, giving special attention to the reign of Queen Elizabeth which extended from 1558 to 1603. At about this time the Lombard merchants, who probably had introduced the practice of marine underwriting into England one or two centuries earlier, were drifting back to Italy, leaving as mementoes the word "policie," which is of Italian derivation, and the name "Lombard Street," which is still mentioned in the English policy. With the aid of the mariner's compass, Drake, Raleigh and other adventurers were sailing to the four quarters of the globe. In this reign, the East India Company was chartered, the Royal Exchange was built—the famous meeting place for underwriters and brokers and subsequently the home of Lloyds—the first lay commissioners were appointed to settle insurance disputes, and the first office was established in London for registering insurance contracts.

The conventional form of the marine insurance contract in common use was simple and one-sided, one-sided in favor of the insured. The only express obligation resting upon him was the duty to pay the premium. If some special warranty was required



to complete the agreement of the parties, it became the subject of present consideration and was added to the policy as a well understood clause. For example, "warranted the ship in good safety;" "warranted the ship is neutral;" "warranted no Gulf of St. Lawrence in winter months;" "warranted not to proceed east of Singapore;" "warranted not to load in excess of a certain tonnage," etc.

On the other hand, the obligations of the underwriters were sweeping and liberal. The policy established by Florentine ordinance of 1523 reads as follows:

> "The said assurers taking upon themselves, the risk of all perils of the seas, fire, jettison, reprisals, robbery by friend or foe, and every other chance, peril, misfortune, disaster, hindrance, misadventure, though such as could not be imagined or supposed to have occurred, or be likely to occur. * * And the insurers are bound first to pay to the aforesaid the sums insured, and to litigate afterwards."

Compare with this policy, if you please, the form of the proposed standard fire policy now before our legislature, for the terms of which the able and untiring efforts of our friends, Mr. Rumsey and Mr. Shallcross are so largely responsible. I am not here to cast reflections upon that policy. Indeed, I felt greatly honored to be able to share in the framing of certain of its provisions. But the truth is that, even in that liberal form, the major part is occupied with restrictive clauses and with statements of what the *insured* must and must not do.

The early English policies, to be sure, were not so impracticable as to require payment of loss before litigation, even upon security furnished to the underwriter, but, nevertheless, you may easily infer that the mercantile community, and subsequently the common law judges, felt under pressure to devise rules which would adequately protect the pioneer insurers from fraud and imposition, and also from mistake as to the character of the risk to be assumed.

In making any correct estimate of the proposed hazard, underwriters, in those early times, were largely at the mercy of the applicant. An inspector could not be despatched over night even to the neighboring cities of Antwerp or Havre to survey ship or cargo. There were no railroads, or steamships or telegraphs. Maritime intelligence traveled slowly. Lloyds' List, with cabled

news from all parts of the civilized world, and Lloyds' Register of Shipping, with detailed description of all vessels, had not yet been so much as thought of; and the Coffee House of Edward Lloyd, in which the marvelous institution of Lloyds, named after him, had its beginnings, had not yet displayed its unpretentious sign in Tower Street. There were no insurance corporations or insurance companies, such as we know. Insurance was a matter of marine underwriting, and of individual dickering without aid of scientific schedules of rates or elaborate surveys of risks.

The owners of ships and shipping merchants were on either side of the contract. In one instance they figured as insurers and in the next as the assured. They were not scattered over a country three thousand miles in width. Most of them were represented in person, or by agents or brokers, in the one metropolis of London, and in that city, not too far from the River Thames. They were extraordinarily well situated for the conduct of their trade, and with the help, doubtless, of certain customs, and ordinances, borrowed from Barcelona, Florence and other cities, they gave shape to regulations for the management of this rapidly expanding business of insurance, so vital to England's prosperity, especially in times of war.

And what were some of the leading doctrines which these lay experts of early times adopted and applied, governed as they were by the surrounding circumstances which I have thus endeavored to portray?

The contract of insurance, they concluded, is peculiarly a contract calling for good faith. It is a speculation in the nature of a bet. The true sport must not bet on a certainty. The subject of the contract of insurance is a chance. Both parties must contract with reference to the same chance. Hence facts material to the risk, known to one party only, must be affirmatively disclosed to the other party. What is naturally unknown to both parties need not be ferreted out and disclosed by either, since the unknown enters into the chance which is to be assumed. If the underwriter, through some private channel, is informed that the proposed adventure is already ended, it would manifestly be a fraud for him to accept a premium for insuring it. No chance remains. If the owner is advised that his ship or cargo is already in peculiar peril, or in any way impaired, and does not say so, the chance to him is one thing, and, to the underwriter, another thing.



This in few words was the doctrine of concealment and the reasons for it. On this subject the policy was silent, but the obligation to disclose material facts was made an implied condition on which the validity of the insurance depended. The rule was exceptional, and at variance with the maxim *caveat emptor*, let the purchaser beware, governing the ordinary contract of sale when unaccompanied by express guaranty. The rule was exceptional in another respect, for at common law the general theory is that where parties have reduced their agreement to writing, the contract as written is presumed to embrace the entire agreement, and, if without ambiguity in its phraseology, is the sole admissible evidence of the agreement. But not so at all in the law of insurance. Here, various important provisions, though unexpressed, have always been implied as a part of the contract of marine insurance; for example, that contributions towards general average losses caused by a peril named are covered by the policy; and that, if the insurance is short of value, the insured is co-insurer for the deficiency.

This same doctrine of fair dealing imposed upon the insured the further implied warranties that at the start the ship must be fit for the adventure, both in structure and equipment, and that it must not deviate from the customary course of the voyage without legal excuse.

Again, the principle was recognized that insurance, in its nature, is a contract of indemnity. Hence the claimant under the policy must show an insurable interest unless the parties had expressly stipulated to the contrary. The doctrine that an insurable interest is essential to sustain the validity of the contract was adopted later, on grounds of public policy. The doctrine of indemnity involved also the right of subrogation, and the right of insurers to exact contribution towards the loss as among themselves, rules with which you are quite familiar.

In actions for tort, contributory negligence on the part of the plaintiff constituted a good defense, but, under the principles of insurance law, indemnity was allowed to the insured for loss by the peril named, despite the contributing negligence of himself or others.

Bearing in mind the form of the early contract, and the manner in which the business was conducted, we are not surprised that where the parties deliberately inserted upon the face of the policy any statement of fact or any promise of perform-

ance, it became a warranty which must be exactly fulfilled, a failure involving forfeiture of the insurance. This doctrine, so conspicuous in the law of insurance, has descended to modern times by force of precedent, and is often applied to our more elaborate and complex policies.

With all proper respect to the merchants and brokers of Britain and other maritime nations, we recognize that friendly awards and trade understandings do not quite fill the place of a system of law elaborated by trained judges, whose decisions are enforcible by sheriffs, and whose opinions are officially reported for the future guidance of the whole community. And though this survey of our subject is necessarily brief we must not altogether ignore the rulings of the courts.

Almost exactly two hundred years after Queen Elizabeth ascended the throne, Lord Mansfield ascended the Kings Bench. He, doubtless, did more than any other judge of any age to systematize the law of insurance. He was a great judge in commercial law generally, and it is said that out of thousands of judgments rendered by him only two cases were reversed on appeal. Up to the beginning of his term in 1756, there had been very few decisions reported in the common law courts on the subject of insurance. To assist him, he established at Guildhall a body of special jurymen, expert in the usages of trade, and Lord Campbell in his "Lives of the Chief Justices" says that one of these jurymen, who wore a cocked hat, had almost as much authority as Chief Justice Mansfield himself.

And now may I ask you to examine with me a few cases, ancient and modern, which I have selected from the official reports with some care to aid us in our present discussion.

On the 27th of June, 1740, the owner of the ship Davy wrote from abroad to his London agent to procure insurance. The letter was received the 25th of the following August. On this day the defendant, as requested, underwrote a policy on the ship Davy, lost or not lost, Carolina, U. S. to Holland. Two days before this the plaintiff's agent had received a letter dated August 21st from an acquaintance who had arrived at Cowes, England, containing these statements: "12th this month I was in company with ship Davy; at 12 in night lost sight of her all at once. Captain spoke to me day before, that he was leaking. Next day hard gale." The contents of this letter were not disclosed to the underwriter when application was made for the policy. The condition



of the vessel, however, had nothing to do with the loss, for the voyage was safely continued until August 19th, when the ship was captured by hostile Spaniards. On the trial at Guildhall, several brokers were called, who testified that the plaintiff's agent ought to have disclosed the letter; that upon disclosure, the underwriter would not have accepted the risk, or would have accepted it only at a higher premium. The jury found for the defendant.

The entire official report of this case [1] occupies little more than half a page, but it is instructive. It shows a leaning upon the opinion and experience of the expert brokers, who were allowed to usurp the function of judge and announce from the witness chair the sound rule of law. The matter concealed may have no relation to the cause of loss; but was it calculated to induce the underwriter to reject the application, or to accept it only at a higher premium? That is the test.

A vessel named Christy Johnstone was insured "at and from Plymouth to the Banks, codfishing, and at and thence back to Plymouth." She took the usual quantity of bait, insufficient, however, for the trip, the practice being to rely principally on catching squid on the Banks to use for bait. This year the squid, though formerly plenty, were scarce, and in order to procure bait the master was obliged to go to the port of St. Peters, the trip thither with return to the banks occupying about a week. Subsequently, while fishing on the banks, the vessel sprung a leak in a severe gale and was totally lost. The court held that while the plaintiff's vessel might have delayed for any reasonable time upon the Banks for the purpose of the voyage, for example in the occupations of fishing or getting bait, without being guilty of deviation, yet to depart from the specified route, though absolutely essential to the successful conduct of the trip, and though the departure had nothing to do with the loss, was in law a deviation, which avoided the policy. [2]

In an English case the insurance was upon any craft employed in loading the ship Britannia. A sloop was so engaged one day in transferring sugar to this ship over a distance of some fifteen miles while the ship was anchored at St. Kitts, West Indies. The sloop was in charge of the ship's mate and three of its seamen and four negro laborers. There is sometimes a suspicion of the presence of Jamaica rum in that region, and, at

(1) Seaman v. Fonereau, 2 Strange 1183.
(2) Burgess v. Equitable Mar. Ins. Co., 126 Mass. 70.

all events, at about eight o'clock in the evening, first the mate and shortly thereafter all the seamen and negroes fell asleep on the sloop, which, thus neglected, drifted ashore where it was seriously injured by winds and waves. Counsel for the underwriter urged that the cause of loss was the negligence and misconduct of the plaintiff's agents, but the court held that the peril insured against, to wit, the winds and the waves, must be taken as the controlling cause, in spite of the proven negligence of the agents of the insured. The court further held that while the warranty of seaworthiness demanded a competent master and crew at the start, it did not require that they should be careful during the voyage. (3)

Another ship was warranted to sail with fifty hands or upwards. In fact, she began the voyage from Liverpool with only forty-six. But six hours later, at the island of Anglesea, she took on six more seamen, making fifty-two in all, and this while the pilot was still aboard, and before there was any occasion for employing more than forty-six. Later, on the high seas, the ship was captured by the enemy. Lord Mansfield held that the policy was avoided by reason of the breach of warranty, in that the voyage was begun without the stipulated fifty hands. (4)

This case strikingly illustrates the severity of the doctrine of warranty in the law of insurance, which is in marked contrast with other branches of the law. For example, a substantial compliance will avail, with equitable adjustment of the contract price, in case of a building contract; and a lease still stands, despite certain breaches of warranty, for which, however, a claim for damages may be recoverable. But the contract of insurance is exceptional; you pay two dollars and purchase two dollars' worth of flour; you pay two dollars and purchase a thousand dollars of insurance, based, however, upon conditions. These conditions evidently constitute a most essential part of the agreement. Except as they are precisely complied with, this great disparity between the amount of premium and the amount of insurance is not equalized.

In another case the ship was warranted to sail with convoy. Voyage from London to Naples. The ship started with convoy, but was separated from the convoy by a tempest, which drove it out to sea, and off its course, where it was captured by pirates.

(3) Walker v. Maitland, (1821) 5 Barnewall & Alderson, 171.
(4) Dehahn v. Hartley, (1786) 1 T. R. 343.



Here was no breach of warranty, for a peril insured against caused the mischief of separation; and another peril insured against was the proximate cause of loss. (5)

Courts in modern times have continued to enforce the strict rule regarding warranties, when the thing warranted is expressed without ambiguity.

Thus, in his accident policy, Gaines warranted that the payee was his wife. Gaines died. The wife brought suit on the policy. It was shown on the trial that when the policy was issued the plaintiff was living with the insured as his wife, to all appearance, and, indeed, had gone through the form of a marriage ceremony with him, but in fact, she had a prior husband living. She was not the lawful wife of the insured. The misstatement as to relationship appeared to be wholly immaterial, and counsel argued that the private affairs of this couple were of no concern to the insurance company; but the New York Court of Appeals held the policy avoided for breach of warranty. (6)

In an Arkansas case the application was made part of the contract of fire insurance and warranted by the insured. In it he stated that his house, on which he requested a policy of $1,200, cost $2,000, when in fact it cost but $1,700. This slight discrepancy, however, seemed unsubstantial, inasmuch as the policy amounted only to $1,200, considerably less than the actual cost of the house. Nevertheless, the majority of the court adjudged the policy void. (7)

In a Virginia case, the insured, having erected his building upon a pier built upon the bed of Chesapeake Bay, rented it to one Livingston, who, without consulting with the insured, gave permission to a man by the name of Wells to set off fireworks on the pier on the night of the Fourth. The insured building was ignited and damaged in consequence. Here not only was the forbidden use temporary, but the insured, having no knowledge of it, was no more at fault than he would have been if his house had been struck by lightning. Nevertheless, the warranty against the use of fireworks on the premises had not been kept, and the recovery by the insured below was reversed on appeal. (8)

Sometimes, however, the literal meaning of a warranty, in a general printed form of contract, seems so incongruous when

(5) Jeffery v. Legender, (1691) 3 Lev. 320.
(6) Gaines v. Fidelity & Cas. Co., 188 N. Y. 411.
(7) Capital Fire Ins. Co., v. King, 82 Ark. 400.
(8) Westchester F. Ins. Co., v. Ocean View Pleasure Pier Co., 106 Va. 633.

applied to the particular instance, that the courts have evaded it, having regard to the main purpose of the contract. An interesting illustration is to be found in a recent case under the English Workmen's Compensation Law. A farmer insured against liability under that law. There was a warranty in the policy that the name of every employee and the amount of wages and salary paid to him should be duly recorded in a wages book. No wages book was kept. The farmer employed only one person, and that his son, at seventy-five pounds a year. The son lost his hand and was paid under the terms of the Act. The judges of Kings Bench on appeal, by a vote of two to one, refused to find a breach of condition avoiding the policy. (9)

By similar course of reasoning, the courts in this country and England, have refused to apply the one year limitation clause of the usual fire insurance policy to a policy of reinsurance, though the standard conditions were a part of it.

In order to avoid technical and seemingly unconscionable forfeitures, the courts, and especially the American courts, have adopted certain rules modifying the strict rule of warranty, and these modifications in certain instances have introduced great uncertainty and confusion into the law of insurance.

The first rule, however, can hardly be criticized. It is that any ambiguity in the language of a policy, the policy being prepared by insurance men and in their interest, shall be resolved by a liberal construction in favor of granting indemnity for the loss.

An admirable illustration is found in New York. The insured personal property was stated to be contained in a storehouse situate detached at least one hundred feet on the east side of Lake Champlain in the town of Shoreham. The court held that this statement must be construed to be a warranty, but they found ambiguity as to what the warranty was. The policy said, "detached at least a hundred feet," but it did not specify the object from which it was detached. It appeared that there was a small building with a little gunpowder in it located seventy-five feet from the storehouse; but it also appeared that this did not increase the risk on the property insured. The court, accordingly, construed the warranty as meaning detached at least a hundred feet from some building which would increase the hazard on the property insured. (10)

(9) In re Bradley, etc., Accident Indem. Soc., (1912) 1 K. B. 415.
(10) Burleigh v. Gebhard Fire Ins. Co., 90 N. Y. 230.



This rule of construction is not a novel one. Lord Mansfield applied it in the year 1778 in a case before him in which the ship was warranted to sail with thirty seamen, besides passengers. To make good the number of thirty seamen it was necessary to count in the steward, the cook, the surgeon and certain boy apprentices on board. Lord Mansfield held that the insured was entitled to do this, and that there was no breach of warranty. (11)

Another rule in mitigation of the strict doctrine of warranty is this, that exact compliance will be required only as applied to statements of fact or promises of performance, and that good faith will be held sufficient in the case of statements of opinion, expectation or belief, though in the form of warranties.

Thus, Owen, the insured, died about a month after procuring a policy from the Metropolitan Life Insurance Company. Defense was made on the ground that, in his application, he had warranted that he had never had heart disease. Owen's heart was seriously affected prior to his proposals, but he did not know it. The court concluded that only good faith was required, and that the jury were at liberty to find that his representation regarding this obscure disease was given according to his *bona fide* belief, and that the policy was not avoided. (12)

The last of these rules that I shall mention at this time is the one which has occasioned the greatest amount of confusion, and that is the doctrine of parol waivers. By this doctrine, though his action is brought upon the policy, the insured is allowed to show by oral evidence of what occurred at or before the making of the contract that the understanding between the parties was radically different from that expressed in the policy. For example, the insured has avoided his policy by reason of other insurance without written permit, or by some breach of warranty. You will recall that the courts of New York and of the majority of the States, allow the insured, or his witness, in such a case, to testify orally that the countersigning agent had knowledge of the other insurance, or the other facts constituting breach, before the policy issued. The agent generally denies this, but the jury attaches little importance to the point one way or the other and, ignoring it, finds for the insured. This rule of course is utterly at variance with common law doctrines of evidence, and is, therefore, rejected by the courts of England,

(11) Bean v. Stupart, 1 Dougl. 11.
(12) Owen v. Metropolitan Life Ins. Co., 74 N. J. L. 770.

by our federal courts and the state courts of Massachusetts and New Jersey.

Basing my opinion upon experience as well as theory, I am convinced that the last named courts have much the better of the argument, both in the interest of justice and of public safety. The sanction of the written agreement is needed for the protection of both parties, if they are honest; and the fire loss *per caput* in this country, as you are well aware, is several fold greater than it is abroad, a fact carrying persuasion that the public are entitled to the benefit of the protective clauses of the policies. Invoking this doctrine of parol waivers, however, claimants, and especially unscrupulous claimants, sweep out of our policies, both fire and life, all the conditions and warranties though inserted therein by legislative enactment, and this is done without the payment of any additional premium. To try the issue before a jury seems to me almost farcical. If the contract as written does not need reforming, it should be enforced as it reads. If it does need reforming, the issue should, in my opinion, be determined, as in all other cases, by a judge sitting in equity, and under the rules of evidence peculiar to that procedure. An equity issue is promptly disposed of in this and many States, and in the same action the insured may collect any insurance money to which he is entitled.

Observing the marked disposition of courts and legislatures to favor the underwriter, under the simple conditions of the early marine policy, and their no less marked disposition to favor the insured, under the modern fire insurance policy, the question presents itself to us, whether it would have been wiser for the fire insurance companies to have omitted from their early policies most of the fine print conditions appertaining to the situation prior to the fire, relying instead upon the two common law doctrines, first, that all matters material to the risk must in general be affirmatively disclosed by the applicant for insurance, and, second, that the insured must not voluntarily enhance the risk during the term of insurance. This inquiry, which has for many years enlisted my interest, has a direct bearing upon the vastly important proposal now pending (March, 1917) to adopt a new and simpler fire insurance policy for the whole country, and I submit the question to you for your decision, suggesting that the marine underwriter has undoubtedly fared far better with the aid of the common law doctrine of concealment, enforced as it is by the



courts, than has the fire insurance company with its express and apparently sweeping warranty upon that subject, limited as it usually is in the United States to intentional or fraudulent concealment. Referring to a fine print condition of an elaborate fire policy in common use before the standard policies were adopted, our Court of Appeals likened the clause to a tiger "crouched unseen in the jungle of printed matter with which a modern policy is overgrown," and thereupon concluded to sustain a finding of waiver. Indeed it may be truly stated, in a general way, that while the implied warranties of the marine policy have been respected by all our courts, the express warranties of the fire and life policies, have been to considerable extent evaded by our courts, though no doubt with the intention of accomplishing justice.

In conclusion, permit me to say that the four doctrines of indemnity, concealment, warranty, and parol waivers, seem to me to be the most distinctive and practically important in the law of insurance. These doctrines and the reasons for their adoption we have thus briefly reviewed, and of necessity in a cursory and incomplete manner.

In the course of this study we have been reminded that in ancient times the business and the law of insurance progressed efficiently side by side. Your society, perhaps more than any other institution in this city, has for many years been furnishing a similar example; and in such worthy efforts I wish you all success.

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